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INTELLIGENCE HIGHLIGHTS NO. 13
WEEK OF 3 AUGUST - 9 AUGUST 1948

SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS

UK provisional approval of the US proposed schedule of reparations shares of Japanese industrial assets revives hope that a final decision may be reached on allocation of Japanese reparations (page 2).

Japanese Communist are apparently losing ground in their current play for broader labor support (page 3).

The formation of the South Korean Government has been completed by Rhee Syngman in such a manner as to insure to himself maximum governmental control (page 3).

In China, the civil war continues unfavorably for the National Government (page 4). Rumored schemes for currency reform to bolster the Government's finances appear to impracticable (page 5). Cooperation between the Communists and Marshal Li Chi-shen is revealed in their planning to hold a political consultative conference to establish a coalition government (page 4). The Tibetan Trade Commission may find the UK not unfavorable toward Tibetan independence aspirations (page 5).

Serious disturbances in the Philippines following the 15 August amnesty registration deadline now appear possible (page 8).

Intensification of the Communist-led insurrection in Burma has called for precautionary measures by the US Embassy Rangoon (page 8).

Section III - Recommendations and summary of important estimate from the papers of a 21-26 June Southeast Asia Regional Conference (page 10).

NOTE: In succeeding sections of this Weekly, the following marginal notations are used:

- (1) Double asterisk (**) --placed at beginning and end of information based solely on "S/S distribution" series.
- (2) Single Asterisk (*) --to flag item containing "S/S distribution" series.
- (3) "A", "B", or "C" --importance, in B/FE's opinion, of the item, with "A" representing the most important ones.

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SECTION II. DEVELOPMENTS IN SPECIFIED AREAS

GENERAL

UK has indicated acceptance of the US proposed schedule of Japanese reparations shares

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The UK states that it is prepared to accept the schedule of reparations shares of Japanese industrial assets proposed by the US and presented to the FEC in November 1947, provided that certain changes are made, the effect of which would raise the UK share from 12 percent to 16 percent. This increase would come from that portion of US and Australian shares which each of these two governments has indicated it is willing to turn back to the reparations "pool" for further distribution. The UK states that it will be responsible for Burma's share and India for that of Pakistan.

In an effort to break a long stalemate on the question of division of Japanese industrial facilities as reparations, the US proposed a schedule which would give each of the eleven FEC countries concerned (US, UK, USSR, Australia, Canada, China, France, India, Netherlands, New Zealand, and Philippines; Burma and Pakistan are seeking admittance) a somewhat smaller percentage than it had hitherto agreed to accept. The US would receive 28 percent, but of this, 18 percent would be held as a "kitty" for subsequent distribution to the other ten nations on any basis mutually agreeable. The proposal was accepted without qualification by Australia, New Zealand, Canada and China and "approved" by France. However, the USSR rejected the proposal. Thereupon, the Department of State sought UK acceptance in order to pave the way for ultimate unanimous acceptance of the US proposal, or at least to make possible a US interim directive to effectuate the division of reparations, backed by 10-member acceptance of the US proposal.

The UK provisional approval of the US proposal may lead to a final decision on allocation of shares on either of the two bases contemplated by the Department of State. However, such a decision would still leave open the question of the amount of reparations finally to be made available. Currently, 30 percent of the tentative reparations list is being distributed as an advance shipment to China, the Philippines, US (for Malaya and Burma) and the Netherlands (for the NEI). However, the inability of the FEC to arrive at a final solution on Japanese reparations has hindered Japanese economic rehabilitation because of the uncertainty as to whether part of the 70 percent still to be made available might not, after all, be left to the Japanese and because of the rapid deterioration of many of the plants being held as possible reparations.

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JAPAN

Communists losing in current play for broader labor support. Japanese Communist attacks on the recent occupation-inspired restrictions on the union activities of government employees may be modified for lack of non-Communist support. Popular scepticism of the success of any defiance of the Occupation may favor Socialist attempts to win labor support by (1) blaming the repressive measures on the Communist extremist tactics; (2) seeking modification of the restrictions through Diet action. With inflationary conditions continuing, however, 2,500,000 government employees who now lack collective bargaining rights may feel forced eventually to align themselves with the Communists.

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KOREA

Formation of South Korean Government completed. Following the selection of Cabinet officers and other major government officials President Rhee Syngman notified UNTCOK on 5 August of the formation of the new Korean Government. While a few of the more technical ministries have gone to well-qualified men without party affiliations, most of Rhee's cabinet appointments are entirely political and are aimed at securing firm control of the new government. Rhee's inclusion of a number of Hankooks in the cabinet, particularly the selection of a Hankook for the highly important Finance post, confirms his dependence on the support of the Hankook Democratic Party to maintain his present powerful position. On the other hand, the selection of Agriculture and Forestry Minister Cho Bong Am, self-styled "anti-Stalin" Communist and leader of the National Assembly faction opposed to both Rhee and the Hankooks, is apparently a nod by Rhee in the direction of his previous declarations condemning partisan attitudes toward and in the new government.

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CHINA

The military position of the National Government, so serious that certain leaders have begun, more or less openly, to take the preliminary steps towards setting up regional alliances, continues to grow worse under a series of widely separated, but continuous, Communist attacks. Recent Communist successes near Facting and at Taiyuan in North China, at Kaifeng and in the rich agricultural regions of Anhwei in Central China all demonstrate that, in these areas, Communist tactics are still primarily guerrilla in character and designed to gather food and materiel, reduce Nationalist holdings, and, wherever possible, annihilate Nationalist units. Current Communist dispositions menace the long-isolated provincial capitals of Tsinnen and Taiyuan, which have been cut off from their normal food producing hinterlands and must now be supplied entirely by costly airborne operations. The fall of these cities to the Communists can be expected by the end of next winter, if not before. A threat of serious proportions is building up in the Nationalist-held corridor between Tientsin and Chinkhsien. Removals of Nationalist troops plus Communist concentrations, including some Manchurian forces, threatens to deprive the Nationalists of the vital Kailan coal mines, source of well over half of the coal consumed, both industrial and non-industrial, in the North China cities and in the lower Yangtze valley. In this situation, the Nationalists face the constant possibility that the large and powerful Communist forces in Manchuria, largely inactive since mid-March, may return to action at any time; a development which could spell the final extinction of Nationalist holdings in North China and Manchuria inasmuch as Nationalist troops in the area are, at best, barely able to cope with currently active Communist units. (A map showing the Military Situation in China on 1 Aug 1948 will be available for ORB Weekly of 13 Aug.)

The Chinese Communists and the Hong Kong dissident group are planning a political consultative conference to discuss the formation of a coalition government. Marshal Li Chi-sen, the Hong Kong dissident leader, indicates that the meeting will take place in North China some time between 10 October and next spring. This is further evidence of the Communist hope of accomplishing the control of China through the political device of a coalition government rather than through military means. The suggestion that it will take place in North China ties in with the recently announced Communist intention to hold a provisional people's congress for the newly consolidated North China Liberated Area. Marshal Li claims that he is not sympathetic to the Communist cause and that in dealing with them he will maintain his own authority. The strength of Li's movement, while untested, appears small and there is little evidence of any connection with other regional leaders. He probably feels that he needs Communist support in order to have any chance of attaining power for himself. Being an opportunist, Li will probably

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cooperate with any group, Communist or otherwise, who will help him gain his ends. While Li might be able to retain a certain independence in the initial stages of the formation of a coalition government with the Communists, it appears likely that the Communists would eventually dominate.

Some of the stiffest criticism the Kuomintang has yet received manifested "C" itself at the Party caucus which took place during the first week of August. The most extreme was a suggestion for the abolition of the position of Tsung tsai (director general) which Chiang Kai-shek has held for the past ten years. The meeting fell into two factions of liberals and conservatives. The purpose of the meeting of top Party members, however, was only to make suggestions for reforms upon which the Generalissimo will act. While it is evident that a large group in the Party is aware of its own weaknesses, it is doubtful that Chiang will make more than a gesture toward the needed Party reorganization.

Manchurian discontent has subsided. Following an agreement reached in "C" Mukden with a personal representative of the Generalissimo for settlement of the Peiping student incident, the Manchurian leaders declared that no further agitation for independence is planned for the time being.

The Tibetan Trade Mission, which has just left the US for a visit to "B" the UK after a stay of several weeks in this country, has declared that it does not have any political objectives. However, its very limited economic objectives in the US, as revealed in its answers to questions on the subject, and its fervent desire to call on the President unaccompanied by any member of the Chinese Embassy in Washington -- which it failed to do -- suggests that the underlying purpose of Tibet is to obtain at least implied recognition as an independent state. Although the Mission has not met with political success in the US, if such was its design, the British may evince greater sympathy toward Tibetan independence aspirations, a possibility of which the Chinese are apprehensive. Great Britain encouraged Tibetan quasi-independence in 1904 by signing a Convention directly with the authorities in Lhasa, as part of a scheme to protect India's northern borders against Imperial Russian encroachments. The UK still has large economic interests in India, and for this and strategic reasons, would desire to combat possible Communist penetrations into India from across the frontiers. The independent Indian states are not in a position to interpose strong resistance. Current unrest in Tibet against the present regime in Lhasa, as well as some Communist penetrations in that area has been indicated in recent, though vague press reports. The British [redacted] control the Indian Mission at Lhasa, are in the most favorable position to evaluate the Tibetan situation and to determine the most profitable course of action from the British standpoint.

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Severe losses sustained by US air carriers operating from China to the US and Europe are reported as resulting from rates quoted by European competitors for the same routes in pounds sterling which can be obtained on the black market in Shanghai for as low as \$3 for one pound against the official rate of \$4. Also the wide fluctuations of the CND and the great difference between the official and black market rates in that currency cause a return in US dollars for less than the quoted fare when the fare is paid in CNC at official rates, which is permitted. "C"

Government Efforts to Tap Foreign Holdings. At a time when China is in "C" urgent need of machinery and equipment to keep essential industries operating, her foreign exchange holdings are reportedly exhausted. In an effort to tap private Chinese holdings abroad (estimated at approximately US \$ 200 million in the US alone) the Government has relaxed the trade controls to permit essential imports paid for by privately-held foreign exchange. Overseas remittances apparently will also be permitted to enter the country in the form of goods rather than foreign exchange. Although it is too early to assess the impact of the new regulations on either imports or the release of private foreign holdings, it is doubtful if the advantages of converting foreign bank accounts into essential commodities will impress individual Chinese as outweighing the advantages of having a safe haven for their funds at this time.

Financial Deterioration Continues in Face of Economic Reform Rumors. "B" Both prices and the black market rate on US Dollars continued to climb during the past week. By Saturday, 7 August, the rate for US \$1 reached a new peak of CN \$10 million, although it receded somewhat before the close of trading. The wholesale price of rice in Shanghai is now about twice as high as it was last month and approximately 100 times the price prevailing this time last year. The retail price of rice has probably advanced at even a faster rate.

Meanwhile the Government has promised that "drastic" economic and financial reforms will be announced shortly. The details of the new program have not been revealed, but many newspapers state that an integral part of the plan will be a new currency backed by gold and exchangeable for US Dollars at the rate of CN \$2 to US \$1. The Ministry of Finance has vigorously denied that currency conversion will be undertaken by the Government at this time, however. Despite these strong denials, it is conceivable that the present currency will depreciate even more rapidly than it has been, on the strength of the rumors that a new monetary system will soon be put into effect. It is not at all unlikely that the rumors have been started and are being perpetuated by large-scale speculators who are counting on a continued devaluation of the CN\$.

In any event, it seems improbable that the Government will or even can

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carry out a successful currency conversion program. Certainly the rumored exchange rate of CN \$2 to US \$1 is either a complete distortion or a rate that will be impossible to maintain for more than a few short days.

<u>The Shanghai Market:</u>	<u>US \$ Exchange (Selling Rate)</u>	<u>Wholesale Price of Rice</u>	
	<u>Official "open"</u>	<u>Blackmarket</u>	<u>per 172 lb picul</u>
This week (5 Aug 48)	CN \$480,000	CN \$7,700,000	CN \$39,500,000
Week ago (29 Jul 48)	480,000	6,800,000	37,000,000
Month ago (5 July 48)	480,000	4,300,000	21,000,000
Year ago (5 Aug 47)	12,000	41,000	410,000

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Serious disturbances may follow 15 August deadline. Serious disturbances in the Philippines in the near future now appear possible. Although President Quirino has extended the Huk registration period to 15 August, utilizing the full length of time allowed by the Philippine Congress, the dissidents have yet to register in large numbers or give any other indication of their desire to cooperate with the Government. On the contrary, the Huks appear to be using amnesty as a lever to force further concessions from the Government. As of 30 July 102 surrenders had been reported by the Philippine Constabulary--7 with and 95 without arms. At a mass meeting in southern Luzon on 31 July at which Huk leader Luis Taruc severely criticized the Government, a provincial Huk commander stated that registration is contingent upon 10 demands which include: no surrender of firearms; replacement of Constabulary Chief--General Castaneda and other government officials by more sympathetic persons; repeal of the parity amendment (which gives US citizens certain economic rights equal to those of Filipinos); and removal of all US air and naval bases in the Philippines. "A"

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Secretary of National Defense Ruperto Kangleon is reported [redacted] to have stated on 5 August that the "Government is being sold out," and to have indicated that following 15 August, the internal defense forces of the Philippines will adopt a strong policy even though President Quirino may continue to make concessions to the Huks. According to same source, Kangleon claims that he has definite information that the President's brother, Judge Antonio Quirino who was the chief negotiator with the Huks, is a Communist, and blames him for the current situation. Judge Quirino enplaned for Spain on 5 August quite possibly in order to be out of the country after 15 August should trouble develop.

BURMA

Insurrection intensified as dissident PVO faction joins Communist. "A" The Communist-led insurrection in Burma has received new impetus by the addition of new recruits from a large faction of the Peoples' Volunteer Organization (PVO) which was recently expelled from the Anti-Fascist Peoples' Freedom League (AFPFL), the Government party. The activities of the insurgents have noticeably increased, particularly around Bassein, an important port for rice shipments, where PVO members of the Government military forces have joined the Communists. The US Embassy in Rangoon considers the situation serious enough to request the US Air Attaché, Bangkok, to stand by in Rangoon in case it becomes necessary to evacuate Americans from Bassein. Furthermore, the Embassy intends to recommend that American women and children residing in dangerous areas be moved to safer places.

Meanwhile, Thakin Nu has announced the initiation of a full-scale drive against the insurgents which was apparently held back heretofore in an attempt to keep the PVO within the AFPFL. Nu has also agreed to remain as Prime Minister until next spring, which is encouraging because he is probably the only Burmese leader capable of holding the remnants of the AFPFL together and at the same time command any appreciable support from ethnic minority groups. Although it is still improbable that the present

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BURMA(continued)

regime will be overthrown in the near future, its position continues to be weakened. The continuance of the present Government in power now depends, to a large degree, on Nu's ability to succeed in the difficult task of the drawing together of anti-communist Burman and minority elements in support of the government. Such a development may be furthered as the intentions of the Communists and their sympathizers become increasingly apparent. It would then be conceivable that the popular antipathy towards "Anglo-American imperialism" would be lessened.

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SECTION III. DIGEST OF IMPORTANT STUDIES AND ESTIMATES

A Southeast Asia Regional Conference under the chairmanship of US Ambassador to Siam, Edwin F. Stanton was held in Bangkok from 21 June to 26 June. The papers and recommendations of this conference, which was attended by over 30 State, Army and Navy officers assigned to posts in Southeast Asia and a few officers from Washington, are of considerable interest and value. Highlights of the conference papers are the estimate of Soviet intentions and capabilities in Southeast Asia and the recommendations that suggest active political warfare against the Soviets and which reveal strong disagreement as to possible courses of US policy and action in Indochina and Indonesia. The texts of the estimate and the conference recommendations are as follows:

"B"

Estimate of Communist Activities in SEA

"The Kremlin seeks to replace the western powers in Southeast Asia, substituting itself by (a) posing as champion of colonial peoples in their struggle for independence, and (b) capitalizing on the discontent of the "have-nots" (in this area, overwhelmingly the peasantry). Specific means of achieving this objective are disrupting the economy of areas still under colonial control, encouraging nationalist movements, seizing control of them to dissipate their strength in efforts to regain and retain their positions in this region.

In pursuit of its aims in SEA, the Kremlin is handicapped by (a) the remoteness of the area, (b) its paucity of dependable and educated intelligence regarding SEA, and (c) its shortage of personnel with first-hand experience in the area. The Kremlin appears, therefore, to have relied thus far upon Chinese communist guidance of SEA communist movements, channeled through the South China CP Bureau in Hong Kong. But it cannot permit this arrangement to continue indefinitely. The recent establishment of a Soviet Legation in Bangkok suggests that the Kremlin intends to play a more direct role in Southeast Asia."

Recommendations

"A. REGIONAL

1. Political Warfare

Because Stalinism is steadily expanding throughout Southeast Asia apparently in accordance with an aggressive and systematic plan, the United States should promptly undertake political warfare against Stalinism in Southeast Asia, based on Siam.

a. USIS operation should be expanded and given sharper political direction.

b. USIS operations should be supplemented by more aggressive forms of political warfare, including careful subsidization of and guidance to selected anti-communist native elements.

c. A carefully selected Labor Attaché should be assigned to Bangkok for operations throughout Southeast Asia for the purpose of awakening the laboring class to the dangers of Stalinism and encouraging their resistance to it.

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d. The United States should throughout Southeast Asia cooperate with the United Kingdom in the conduct of political warfare against Stalinism.

e. Being careful not to make the Filipinos "lose face" or give any open justification to charges that the Philippines is an American satellite, the United States should seek throughout Southeast Asia to capitalize on our favorable colonial record in the Philippines and induce the Philippines to cooperate with and in some cases independently to further United States policy.

f. The United States should in general favor the development of any suitable anti-communist regional organization in Southeast Asia.

2. Chinese Minorities

Keeping in mind the dangers of becoming involved in internal Southeast Asian affairs, using the utmost discretion, and when appropriate occasion presents itself, Southeast Asian governments should be encouraged to assist Chinese minorities to be assimilated and at the same time assure their legitimate minority rights. Where appropriate the same views should be brought to the attention of the Chinese government.

B. INDIVIDUAL SOUTHEAST ASIA COUNTRIES

1. Burma

a. Because there appears to be no present Burmese leader of stature who can withstand the communists, it is the tentative opinion of the conference that the United States should discreetly support any anti-communist leaders who show promise of coming to power.

b. No international bank loan should be granted to Burma unless there is a drastic change in Burmese policy away from communism.

2. Indochina and Indonesia

The conference attaches two alternative policy suggestions, each, for the Indochina and Indonesia problems which were prepared at the conference.

The conference, however, did not vote on nor express its opinion on these suggestions and limits itself on the exceedingly complex subject of United States policy toward Indochina and Indonesia to the following statement:

An early settlement of the Indochinese and Indonesian problems is in the political and economic interests of the United States, the Southeast Asia region and Western Europe. Failure to reach such a settlement is to play into the hands of the Kremlin and ultimately to jeopardize the security of the United States."

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